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Chamber of Commerce of the U.S. of America

Referendum no. 34

[Washington]

[1920]

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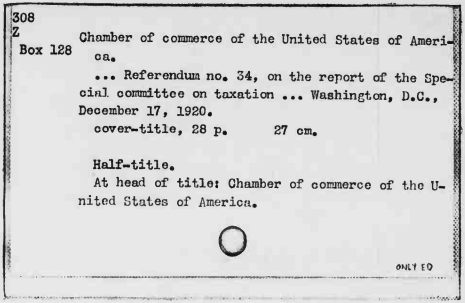

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Chamber of commerce of the United States of America.

... Referendum no. 34, on the report of the Special committee on taxation ... Washington, D.C., December 17, 1920.

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Half-title.

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No.....

CHAMBER OF COMMERCE

OF THE

UNITED STATES OF AMERICA

REFERENDUM No. 34

On the Report of the Special Committee on Taxation

NATIONAL HEADQUARTERS: MILLS BUILDING
WASHINGTON, D. C.

December 17, 1920

BY-LAWS

ARTICLE XIII

SUBMISSION OF QUESTIONS

SECTION 1. All subjects considered or acted upon by this Chamber shall be national in character, timely in importance, and general in application to business and industry.

SECTION 2. All propositions, resolutions, or questions, except those which involve points of order or matters of personal privilege, shall be submitted for action in writing only by the organization members, or by the National Council, or by the Board of Directors: *Provided*, That by consent of two-thirds of the delegates present at a meeting a subject not so presented may be considered.

SECTION 3. When an organization member desires to present a subject for the consideration of this Chamber it shall commit its proposals to writing in the form of a resolution duly adopted by said organization or its governing body and forward it to the Secretary.

It shall be the duty of the Secretary to bring this subject before the Board of Directors by mail, or at its first meeting, whereupon the Directors shall decide whether or not the subject is of national character, timely in importance and general in application to business and industry. If the Board of Directors decides that a subject submitted by an organization member is not of national character, timely in importance, and general in application to business and industry, and should not therefore be submitted to the membership for consideration, the proposing member may appeal from the decision of the Board to the National Council at any meeting of that body or by mail through the office of the Secretary. If the National Council decides by a majority vote that the subject should be referred to the membership it shall be incumbent on the Board of Directors to order its submission.

SECTION 4. If the eligibility of the subject has been determined the Board of Directors shall decide whether the subject shall be submitted for consideration by the Chamber in annual or special meeting or by referendum.

SECTION 5. REFERENDUM. A subject to be submitted to referendum shall as soon as practicable be referred to a committee for report. If the report when received is in proper and adequate form for submission to the membership, the Board of Directors shall order it to be incorporated in a referendum pamphlet without committing itself in favor or against any of its recommendations, but if not in proper and adequate form it shall refer it back to the committee or appoint a new committee to report on the subject.

SECTION 6. The referendum pamphlet shall contain in addition to the report itself a brief of the major arguments against the recommendations of the committee and such other matter as the Board may deem advisable. If the subject has been submitted by a member organization, said organization shall have the privilege of incorporating in the pamphlet a brief of such length as the Board may determine. The pamphlet shall also contain a ballot upon which the member organizations may register their votes respecting the questions submitted.

SECTION 7. The pamphlet in the form in which it is approved by the Board shall be transmitted to each member of the Chamber in good standing and simultaneously the Secretary shall mail a copy to the National Councillor representing each organization member.

SECTION 8. The pamphlet shall be accompanied by a notice from the Secretary that each organization member is expected to register its vote on the ballot in writing and mail said ballot to reach the National Headquarters within 45 days from the date of issuance of the pamphlet. Each organization may cast one such vote for each delegate to which it is entitled in the annual meeting. No vote shall be valid unless received by the Secretary within 45 days of the date of the mailing of the pamphlet. In connection with its vote each organization member may file such explanation, comment, or opinion as it may desire.

In forwarding the pamphlet it shall be the duty of the Secretary to advise each organization member of the date on which the right to register votes expires.

(Continued on third page of cover)

BALLOT

(To be detached) No. _____

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA
MILLS BUILDING

Washington, D. C., December 15, 1920

TO THE SECRETARY:

Your organization, as a member in good standing of the Chamber of Commerce of the United States of America, is requested to register its vote upon the questions submitted herewith in the referendum pamphlet dated December 15, 1920, and mailed to you on or about the *earliest date practicable* to the Secretary at the National Headquarters, Mills Building, Washington, D. C.

This referendum is taken for the information and guidance of the Board of Directors in its action upon the matters presented.

By order of the Board of Directors,

Elliot H. Goodwin
Secretary and Treasurer

This Ballot will be counted only if received at National Headquarters, Mills Building, Washington, D. C., on or before January 31, 1921. (See By-Laws, Article XIII, on inside of cover.

TO THE SECRETARY,
of the CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,
Mills Building, Washington, D. C.

SIR:

The _____
(Name of Organization)

is a member in good standing in the CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, and having a total membership of _____ is entitled to _____ votes. It desires to have its vote recorded as noted below:

I *The excess-profits tax should be repealed.*

	IN FAVOR
	OPPOSED

II *Revenues now derived from the excess-profits tax should be obtained primarily from taxes on incomes.*

	IN FAVOR
	OPPOSED

III *There should also be excise taxes upon some articles of luxury but not upon articles of first necessity.*

	IN FAVOR
	OPPOSED

IV *Should a sales tax be levied instead of the taxes mentioned in proposals II and III above?*

	IN FAVOR
	OPPOSED

V *Should a sales tax be levied in addition to such taxes as are mentioned in propositions II and III above?*

	IN FAVOR
	OPPOSED

VI *Members voting in favor of question IV or question V above are asked to indicate below the type of sales tax they advocate. Vote for one only.*

(a) *A General Turnover Tax* ☐ IN FAVOR

(b) *A Limited Turnover Tax* ☐ IN FAVOR

(c) *A Retail Sales Tax* ☐ IN FAVOR

[OVER]

INTENTIONAL SECOND EXPOSURE

BALLOT

(To be detached) No. .....

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA
MILLS BUILDING

WASHINGTON, D. C., December 17, 1920

TO THE SECRETARY:

Your organization, as a member of the CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, is requested to register its vote upon the questions submitted herewith on this ballot, which is to be detached and sent by registered mail *at the earliest date practicable* to the Secretary at the National Headquarters, Mills Building, Washington, D. C.

This referendum is taken for the instruction and guidance of the Board of Directors in its action upon the questions presented.

By order of the Board of Directors.

Elliot H. Goodwin
Resident Vice President

This Ballot will be counted only if received at National Headquarters, Mills Building, Washington, D. C., on or before January 31, 1921. (See By-Laws, Article XIII, on inside of cover.)

TO THE SECRETARY 1921
of the CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,
Mills Building, Washington, D. C.

SIR:

The .....
(Name of Organization)

is a member in good standing in the CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, and having a total membership of.....is entitled to.....votes. It desires these votes to be recorded as noted below:

I *The excess-profits tax should be repealed.* See pages 6 and 7

	IN FAVOR
	OPPOSED

II *Revenues now derived from the excess-profits tax should be obtained mainly from taxes on incomes.* See pages 8 and 9

	IN FAVOR
	OPPOSED

III *There should also be excise taxes upon some articles of wide use but not of first necessity.* See pages 8 and 9

	IN FAVOR
	OPPOSED

IV *Should a sales tax be levied instead of the taxes mentioned in proposals II and III above?* See pages 8-13

	IN FAVOR
	OPPOSED

V *Should a sales tax be levied in addition to such taxes as are mentioned in propositions II and III above?* See pages 8-13

	IN FAVOR
	OPPOSED

VI *Members voting in favor of question IV or question V above are asked to indicate below the type of sales tax they advocate: (vote for one only)*

(a) A General Turnover Tax.	☐ IN FAVOR	See page 8
(b) A Limited Turnover Tax.	☐ IN FAVOR	See page 8
(c) A Retail Sales Tax.	☐ IN FAVOR	See page 10

[OVER]

VII *There should be a moderate and graduated undistributed-earnings tax on corporations.* See pages 12-15

	IN FAVOR
	OPPOSED

VIII *Each individual stockholder of a corporation should pay his own normal tax.* See pages 14 and 15

	IN FAVOR
	OPPOSED

IX *Income from any new issues of securities which may lawfully be made subject to federal tax should be taxable.* See pages 16-19

	IN FAVOR
	OPPOSED

X *American citizens resident abroad should be exempt from the American tax upon income derived abroad and not remitted to the United States.* See pages 18 and 19

	IN FAVOR
	OPPOSED

XI *Profits arising from sale of capital assets should be allocated over the period in which earned and taxed at the rates for the several years in the period.* See pages 20 and 21

	IN FAVOR
	OPPOSED

XII *An exchange of property of a like or similar nature should be considered merely as a replacement.* See pages 20 and 21

	IN FAVOR
	OPPOSED

XIII *Net losses and inventory losses in any taxable year should cause redetermination of taxes on income of the preceding year.* See pages 22 and 23

	IN FAVOR
	OPPOSED

XIV *Ascertainment by the government of any tax based on income should precede payment.* See pages 24 and 25

	IN FAVOR
	OPPOSED

XV *Administration of income taxation should be decentralized.* See pages 24-26

	IN FAVOR
	OPPOSED

Attest:

.....

Signature of President or Secretary.

INSTRUCTIONS to MEMBERS

The Board of Directors of the Chamber of Commerce of the United States has adopted the following instructions for members, and directed they be printed in connection with the ballot.

1. Each organization member in good standing may cast one vote for each delegate to which it is entitled in the Annual Meeting.

2. The ballot shall be marked by entering a cross or the number of votes to which the organization member is entitled in the square at the left of the words "In favor" if the recommendation is favored, or at the left of the word "Opposed" if the recommendation is opposed.

3. If the organization member desires to have its vote recorded as divided it may do so by entering the vote to which it is entitled in the squares to the left of the words "In favor" and "Opposed" in such proportion as it sees fit. The total vote in the two squares must not exceed the total number of votes to which the organization member is entitled.

4. Fractional votes less than one-half shall not be entered. If so entered they shall on the canvass be carried to the nearest whole number.

5. The ballots which are so marked as to be clearly intelligible shall be counted. Where the sum of the numbers entered in the squares exceeds the total number of votes to which an organization member is entitled, canvassers shall in no case attempt to divide the votes but shall enter them as "In favor" or "Opposed" in accordance with the majority vote shown on the ballot.

DUPLICATE BALLOT

(Not to be detached)

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA

MILLS BUILDING

WASHINGTON, D. C., December 17, 1920

TO THE SECRETARY:

Your organization, as a member of the CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, is requested to register its vote upon the questions submitted herewith on this ballot, which is to be detached and sent by registered mail *at the earliest date practicable* to the Secretary at the National Headquarters, Mills Building, Washington, D. C.

This referendum is taken for the instruction and guidance of the Board of Directors in its action upon the questions presented.

By order of the Board of Directors.

Elliott H. Goodwin
Resident Vice President

This Ballot will be counted only if received at National Headquarters, Mills Building, Washington, D. C., on or before January 31, 1921. (See By-Laws, Article XIII, on inside of cover.)

TO THE SECRETARY 1921
of the CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,
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SIR:

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	IN FAVOR
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VII *There should be a moderate and graduated undistributed-earnings tax on corporations.* See pages 12-15

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VIII *Each individual stockholder of a corporation should pay his own normal tax.* See pages 14 and 15

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IX *Income from any new issues of securities which may lawfully be made subject to federal tax should be taxable.* See pages 16-19

	IN FAVOR
	OPPOSED

X *American citizens resident abroad should be exempt from the American tax upon income derived abroad and not remitted to the United States.* See pages 18 and 19

	IN FAVOR
	OPPOSED

XI *Profits arising from sale of capital assets should be allocated over the period in which earned and taxed at the rates for the several years in the period.* See pages 20 and 21

	IN FAVOR
	OPPOSED

XII *An exchange of property of a like or similar nature should be considered merely as a replacement.* See pages 20 and 21

	IN FAVOR
	OPPOSED

XIII *Net losses and inventory losses in any taxable year should cause redetermination of taxes on income of the preceding year.* See pages 22 and 23

	IN FAVOR
	OPPOSED

XIV *Ascertainment by the government of any tax based on income should precede payment.* See pages 24 and 25

	IN FAVOR
	OPPOSED

XV *Administration of income taxation should be decentralized.* See pages 24-26

	IN FAVOR
	OPPOSED

Attest:

.....

Signature of President or Secretary.

INSTRUCTIONS to MEMBERS

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1. Each organization member in good standing may cast one vote for each delegate to which it is entitled in the Annual Meeting.

2. The ballot shall be marked by entering a cross or the number of votes to which the organization member is entitled in the square at the left of the words "In favor" if the recommendation is favored, or at the left of the word "Opposed" if the recommendation is opposed.

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CHAMBER OF COMMERCE

OF THE

UNITED STATES OF AMERICA

REFERENDUM No. 34

On the

Report of the Special Committee on

Taxation

CONTENTS

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3.	Report of the Committee	4
4.	Arguments in the Negative	5
5.	Report of Minority of Committee: Corporate Income Tax	27

Explanation

THE Board of Directors in authorizing submission of a report to referendum neither approves the report nor dissents from it. In order to inform the members as fully as practicable on the subject submitted to referendum a carefully selected committee is appointed to analyze each question and report its conclusions. The purpose of the referendum is to ascertain the opinion of the commercial organizations of the country, not to secure the approval of the recommendations voiced in the report. Only the vote of the member organizations can commit the Chamber of Commerce of the United States for or against any of the recommendations submitted by the committee and until such vote is taken the report rests solely upon the authority of those who have signed it.

A.D.L. Aug. 16, 22

REFERENDUM
on the
REPORT OF THE SPECIAL COMMITTEE ON
Taxation

STATEMENT OF QUESTION

Questions of national finance have had attention from the Chamber of Commerce of the United States from the time of its inception. During the war with Germany, methods to be used in financing the war and policies in taxation were repeatedly submitted to the membership for referendum vote.

In 1919 the Board of Directors authorized the appointment of a committee to consider the policies the country should follow in internal taxation during the period after the close of war. To this committee have been referred the problems and suggestions which have since been received. In January, 1920, the committee entered upon the inquiries which have now resulted in a final report. This report the Board of Directors has ordered should be submitted to referendum vote in accordance with the request of the Chamber's Eighth Annual Meeting, which asked that, at the earliest date consistent with the deliberation and the thought appropriate for the subject, the Committee on Taxation should present a "report setting out a program of federal taxation for the immediate period of readjustment, and that this report be submitted, in the customary manner, to the membership for a referendum vote."

The members of the Committee on Taxation are:

R. G. RHETT, *Chairman*, Charleston, S. C.
ARTHUR ANDERSEN, Chicago,
R. G. ELLIOTT, Chicago,
JOHN H. GRAY, Northfield, Minn.,
FRED R. FAIRCHILD, New Haven,
J. LAURENCE LAUGHLIN, Boston,
JESSE ISIDOR STRAUS, New York City,
THOMAS B. STEARNS, Denver,
ERNEST W. STIX, St. Louis.

For the greater convenience of members of the Chamber, and in order that they may the more readily have before them both the affirmative and the negative arguments respecting each important point, the arguments in the negative are in this pamphlet printed upon the page directly opposite to the page of the report to which they refer. This arrangement causes the pages of the report and the arguments in the negative to alternate. The contents of the pamphlet accordingly are:

		Page
(1)	The Committee's Report	4
(2)	Arguments in the Negative	5
(3)	Report of Minority of Committee: Corporate Income Tax	27

PERSONNEL OF COMMITTEE

RHETT, R. GOODWYN, *Chairman*: Banker and manufacturer, of Charleston, South Carolina; president of Peoples National Bank, Charleston; formerly president of the Charleston Chamber of Commerce and formerly president of the Chamber of Commerce of the United States.

ANDERSEN, ARTHUR: Accountant, of Chicago; senior partner, Arthur Andersen & Co., certified public accountants; professor of accountancy, School of Commerce, Northwestern University; member, Chicago Association of Commerce.

ELLIOTT, R. G.: Manufacturer, of Chicago; an official of the Jaques Manufacturing Company; a member of the board of directors of the National Association of Credit Men, and chairman of that organization's committee on taxation.

FAIRCHILD, FRED R.: Economist, of New Haven, Connecticut; professor of economics in Yale University; formerly member of the Connecticut Commission on Taxation, expert in taxation of United States Forestry Service, and tax adviser to the military government of Santo Domingo.

GRAY, JOHN H.: Economist, of Northfield, Minnesota; professor of economics in Carleton College and consulting expert of the Bureau of Valuation, Interstate Commerce Commission; formerly head of the department of economics, University of Minnesota, and director of investigation of regulation of public service corporations for National Civic Federation; during the war a member of the board of appraisers of property commandeered by the Army.

LAUGHLIN, J. LAURENCE: Economist, of Boston; professor emeritus of economics, University of Chicago; formerly chairman of executive committee of National Citizens League for the Promotion of a Sound Banking System.

STEARNS, THOMAS B.: Mining engineer and manufacturer, of Denver; president, Stearns-Roger Manufacturing Company; director in various enterprises, including mining companies and public utilities; a director of the Denver Civic and Commercial Association, and formerly its president; formerly a director of the Chamber of Commerce of the United States, and formerly Food Administrator for Colorado.

STEWART, HAMILTON: Manufacturer, of Pittsburgh; vice-president, Harbinson-Walker Refractories Company; director, Barrett Company, Pittsburgh By-Products Coke Company, etc.; formerly vice-president, Pittsburgh Chamber of Commerce.

STIX, ERNEST W.: Wholesale merchant, of St. Louis; president, Rice-Stix Dry Goods Company; member of the National Wholesale Dry Goods Association and of St. Louis Chamber of Commerce.

*STRAUS, JESSE ISIDOR: Merchant, of New York City; president of R. H. Macy & Co.; formerly vice-president, National Retail Dry Goods Association.

*Mr. Straus, being absent in Europe, did not participate in meetings of the committee held in the autumn of 1920.

The Committee's Report and the Arguments in the Negative, which are prepared by the Chamber's staff as an outline of possibly adverse considerations which have come to its attention, are in this pamphlet placed upon opposite pages. This arrangement supplants the earlier practice of placing the negative arguments after the report. In this pamphlet, the report appears only upon the pages to the left, whereas the negative arguments occupy the pages to the right. Immediately following this portion of the pamphlet appears a report of a minority of the Committee respecting one point on which the minority dissents.

REPORT

of the

COMMITTEE ON TAXATION

To the Board of Directors of the Chamber of Commerce of the United States:

War Financing

Beginning promptly after the United States declared war, the Chamber advocated heavy taxation and other policies which would yield the largest possible revenues to the government out of the country's savings and proportionately avoid the financing of war through expedients which would have their effects in increased prices and all of the results that follow.

Post-War Financing

Measures for financial readjustment which must now be taken by our government are equally urgent and as unmistakable. They have already been delayed. Provisions which were formulated under war conditions, and intended to operate only as correctives to other war factors, have been allowed to continue in force by themselves, to the general public detriment. It is now time to prepare a vigorous program of revision for our taxation, not in amount of yield but in the manner of levying important taxes, and such a revision should be immediately effected.

Some postulates may be set down in the beginning, to be recalled as guiding principles as each item of the program is elaborated. Our country has a great war debt, the national treasury still shows deficits, and large amounts of the public debt will fall due in the early future.

Government Economy

Whether a country is rich or poor in potential resources, such a condition of affairs demands thorough economy on the government's part.

Private Economy

Thrift and prevention of waste must be practiced, not only by the government, but also by the private citizen; for the vast destruction of war can be made good only in this way and through new production. In order that production may develop with the country's needs, every obstacle of an artificial nature must be removed.

Taxation

Frank recognition of the situation brings realization that the country must continue for several years to bear a heavy burden of taxation. That very burden implies public obligations of the highest magnitude for the government itself. It must seek to use the proceeds of such taxes only for purposes which are essential, and with strict economy.

Reduction of Floating Debt

All the government can save by the closest scrutiny of expenditures it must devote to reducing the billions of floating debt and to banishing the annual deficits in the Treasury. If any part of the revenues then remains during the next few years, it should be applied

Continued on page 6

ARGUMENTS IN THE NEGATIVE

Financial Program

Having been asked to consider only internal taxation, the Committee begins with the proposition that the government's revenues from this source should for the present be maintained. This is a matter of judgment based upon the government's financial situation, and opinions may differ.

Public Debt

The public debt reached its maximum in August, 1919. The gross amount then was $26,596,000,000. This included the prewar debt. Upon October 31, 1919, this total stood at $26,210,000,000, of which certificates of indebtedness represented $3,736,000,000. From April 7, 1917, the gross debt had increased by $24,928,000,000. In the war period to October 31, 1919, revenues from other sources than sale of bonds, etc., had been $11,280,000,000 against total government expenditures of $35,413,000,000. In the revenues $10,089,000,000 represented taxes, with the rest coming from fees, salvage, and other miscellaneous sources. Thus, taxes met about 29% of the total expenditures.

Taxes Compared to Expenditures

The portion met through taxes on income and excess profits was 19%, and through other internal taxes was approximately 8%. If from the total expenditures the loans to allied governments were deducted ($9,416,000,000), and the percentages were computed only on the balance,—$25,997,000,000,—the part raised by taxation would be 39%, through taxes on incomes and excess profits would be 25%, and through other internal taxes about 10%.

Omitting Foreign Loans

To November 1, 1920

Between the end of October, 1919, and November 1, 1920, the government's expenditures for all purposes except upon the principal of the public debt were $5,095,000,000 ($4,880,000,000 if there are deducted $174,000,000 invested in obligations of foreign governments and approximately $40,000,000 invested in farm-loan bonds), and its revenue receipts were $6,178,000,000, of which $5,590,000,000 came from taxes, including $3,779,000,000 from taxes on incomes and excess profits and $1,670,000,000 from other internal taxes. Thus, to November 1, 1920, the government's expenditures since April 7, 1917, had been $40,510,000,000, and the part met by taxation was $15,860,000,000, or 39%, with the portion of the expenditures raised by taxes on incomes and profits 25% and from other internal taxes about 10%.

Debt on November 1, 1920

In the twelve months preceding the end of October, 1920, the gross debt declined from $26,210,000,000 to $24,062,000,000. By the more important parts of the debt the reductions were $463,000 in prewar bonds, $738,000,000 in Liberty bonds, $176,000,000 in Victory notes, and $1,106,000,000 in certificates of indebtedness.

Securities in Treasury

Against the total debt the Treasury has about $11,000,000,000 in securities, if they are taken at face value. The latest figures available are as of August 31, 1920, when the total was $11,164,000,000, divided as follows by principal amounts:

Obligations of foreign governments for cash advances	$9,450,000,000
Foreign obligations for surplus war supplies	563,000,000
Foreign obligations for relief	84,000,000
Capital stock of various government corporations, such as Emergency Fleet, Housing Corporation, War Finance Corporation, etc.	415,000,000
Obligations of railroads	469,000,000
Stock in farm-loan banks	6,000,000
Farm-loan bonds	175,000,000

Surplus War Supplies

The ultimate realization on these securities as a whole will probably be excellent, even though there may be some doubt as to the worth of a few of the items. About the exact realization from supplies, etc., acquired for war purposes there is also some doubt, but upon the basis of the Secretary of War's statements it may be estimated that the Treasury will ultimately receive at least $750,000,000 from this department on account of salvage, payments from Germany for the costs of maintaining our forces of occupation, etc. To the end of October, 1920, the Shipping Board's total acquisition of vessels of all types aggregated upwards of 10,000,000 tons deadweight. After all allowances have been made, it would appear there should remain net assets in marketable steel vessels that would realize several hundred million dollars to be turned into the Treasury.

Government-Owned Vessels, etc.

Realizable Assets

Total realization from securities now held in the Treasury and from other property described above, together with an amount in back taxes which can still be collected and which on official statements can be conservatively estimated at $1,000,000,000, should produce at least $13,000,000,000,—or $3,500,000,000 more than the part of the public debt which is now treated as self-liquidating and hence not to be retired through taxation. The amount annually placed in the sinking fund, now so arranged as to retire the debt in 25 years, could be proportionately reduced.

Continued on page 7

Annual Interest

upon the public debt, in order that the country's current interest charge of approximately a billion dollars may be diminished. This is no time for diversion of the receipts from heavy taxes, gladly assumed in patriotic support of war, to new undertakings of doubtful public benefit.

Recommendation
Excess-Profits Tax

Bearing in mind the considerations we have outlined, *we recommend that the excess-profits tax should at once be repealed.* The reasons for levying this tax have passed, and its continuance delays the progress of readjustment. Introducing ever-shifting questions because it involves "invested capital" as a factor, and producing inequities of many kinds among competitors who should be treated equally, it encounters an objection which is paramount over all others, in that the Treasury Department has declared it is unable to organize the machinery necessary to administer this tax if it is continued. The Treasury's difficulties are apparent through the circumstance that, with its great and highly organized staff, it has not yet been able to audit all the returns for 1917. It is equally objectionable to the taxpayer because of its uncertainty, both as to its incidence and as to its amount. No tax that defies speedy and efficient administration, and is uncertain, should be permitted to remain on the statute books.

Cannot be Administered

The government has another very direct interest by reason of the necessity of certainty in its revenues. A return to normal conditions will tend to remove excess profits and will correspondingly decrease the proceeds of a tax on them. The result will be that the Treasury will be left without adequate resources.

Encourages Extravagance

In a period after a great war, when every consideration, private and public, requires economy and devotion of all possible savings to industry and commerce, a form of taxation which places a premium on extravagance in the conduct of business enterprise is detrimental to the public interest. The excess-profits tax is such a form of taxation. If the business man feels that a great part of his profits will be taken by the government, he has less incentive to exercise that care and judgment which should be counted upon to reduce production cost to the minimum. When the earnings of a corporation are sufficient to place it in the highest bracket of tax rates, any additional expenditure, whether wise or questionable, is today borne to the extent of 54% by the corporation, and the other 46% represents a loss in tax to the government. Such a situation impairs the inducement to avoid waste and extravagance. Net taxable income has been correspondingly decreased, and the revenue from the corporate income tax and from surtaxes on dividends proportionately diminished. The collection of the excess-profits tax has actually tended to dry up the sources from which income taxes provide their yield to the Treasury.

Reduction in Taxation not Proposed

In proposing repeal of the excess-profits tax the committee does not contemplate a reduction in the government's revenues. Elimination of the profits tax will in itself, both because it will no longer be

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Early Maturities

There may be more immediate problems than the ultimate adjustment of the debt. The short-term debt, in certificates of indebtedness, on December 1, 1920, was $2,767,000,000, all due within a year. There follow war savings securities of $800,000,000 and more which begin to mature in January, 1923. Finally, there are $4,237,000,000 in Victory notes which are due not later than May, 1923. Other lesser amounts bring the total due before the middle of 1923 over $7,500,000,000.

Present Policy

The present Treasury plan contemplates retirement of all certificates of indebtedness and $500,000,000 of Victory notes out of taxes and salvage by July 1, 1922, acceptance of $500,000,000 more Victory notes in payment of income taxes in the following eleven months, and dealing with a principal of $3,000,000,000 of this issue at maturity, presumably through refunding in bonds due yearly in amounts which will permit their retirement and the retirement of the third Liberty loan ($3,659,000,000, due in 1928) so far as it had not meanwhile been met out of proceeds of the securities held by the Treasury. An alternate plan might be to place current revenues on a basis sufficient merely for current expenses, fund the certificates of indebtedness, even if the interest rate would have to be high, and seek to meet the other early maturities by collecting taxes due in earlier years but not paid and by proceeding vigorously with liquidation of such assets as those in the control of the Shipping Board. In considering the policy to be followed it is to be remembered that federal levies do not constitute the whole tax burden. A conservative estimate would seem to place the amount now collected in taxes by states and local governments well over $2,000,000,000. It is also to be remembered that out of the total of the yearly net income in the country must come not only taxes but also the new capital required for business enterprise, and there have been estimates that the railroads alone need over a billion a year. Finally, it must be recalled that taxation which is so heavy as to cause taxpayers to borrow to pay taxes has the same effect in inflating prices as if the government itself floated loans that were not bought out of savings.

Possible Other Plan

State and City Taxes

Current Expenses

In the absence of budgetary procedure, any precise estimates of annual expenditures is impossible. It would seem, however, that after the present year, if large appropriations for new purposes are avoided, annual expenditures need not exceed $4,000,000,000, with the important items about as follows:

Service of public debt (interest and sinking fund)	$1,250,000,000
Support of government activities (except about $500,000,000 for the postal service, which is assumed to be self-supporting)	2,750,000,000

Year Ending June 30, 1921

The appropriations already made for the current year for all purposes except the postal service aggregate $4,360,000,000, including $725,000,000 on account of railroads,—a temporary object of expenditure. These appropriations may be grouped by functions roughly as follows:

Appropriations mainly incident to past wars (debt service, pensions, railroad control, etc.)	$2,838,000,000
Present national defense	855,000,000
Civil functions, exclusive of postal service	481,000,000
Deficiencies in earlier years	186,000,000

It would appear from earlier experience, however, that the present session of Congress will have to make further appropriations for ordinary governmental activities and in October the Secretary of the Treasury estimated that the appropriations in connection with the ending of federal control of railroads will have to be increased by $250,000,000. Expenditures for all purposes, including public-debt service but excluding postal service, may therefore be in the neighborhood of $5,000,000,000 for the current year ending with next June. For the following year, ended with June, 1922, estimates contemplate $4,068,000,000 of expenditures. It may be argued that Congress should at once proceed to a reorganization of government departments and a consolidation of activities with a view to reducing the appropriations needed in future years for support of the functions being performed.

Year Ending June 30, 1922

There are some reasons for keeping the excess-profits tax.

Excess-Profits Tax

Original difficulties in administration and for the corporations subject to tax have now in large measure been solved through ascertainment of invested capital, etc., for the years that are past. It may be advantageous from the public and the private point of view to keep a tax to which business has become adjusted even though the tax is erroneous in principle, rather than to change to a new tax which theoretically may be sounder and which will initially cause difficulties that cannot be foreseen.

Adjustments Now Made

Principle Involved

In principle the excess-profits tax is not inequitable, as it in effect involves application to corporations of the test of ability to pay,—the test used in the income tax on individuals. The proper course, therefore, might be to improve the tax, rather

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deducted before income tax is levied and by reason of new incentive to economy in business conduct, increase the yield from income taxes on corporations and individuals, and this increase will be large.

Recommendation
Income Taxes

Disregarding this effect, however, *the Committee recommends that the revenues now derived from the excess-profits tax should be obtained mainly from taxes on incomes.* After very careful consideration, the committee has reached the conclusion that it is most consistent with the principles of correct taxation to raise additional revenue at the point where it will cause the smallest interference with the proper conduct of business and will have the least influence upon the prices which consumers pay. In the Committee's opinion, and in view of other recommendations the Committee makes in this report, the revenues which are under consideration in this paragraph should be obtained through moderate increases in the lower part of the schedule of surtaxes upon individual income.

Excise Taxes

When making this recommendation respecting taxes on incomes the Committee has in mind the undesirability from the point of view of the government of dependence too largely upon any one source of revenue. Too great reliance upon one source of revenue may seriously disturb the government's fiscal program, in the event that adverse circumstances beyond the government's control affect the source. It is sound public policy to have revenues derived in important measure from several sources.

Recommendation

The Committee accordingly recommends that there should be imposed excise taxes upon a few articles so produced that the tax may be easily collected and of such a nature that, while widely used, the articles are not of the first necessity. Rates for these taxes might vary with the degree of necessity of the articles chosen, but could produce large revenues because of the number of units to which low rates could attach. Such taxes should fall only upon commodities,—ordinarily at the point where the article takes its finished form and is ready to enter the channels of distribution,—and should be levied only once on each commodity. They should not be assessed upon services or any incident to production or distribution. Taxes of this kind will correspond to the excise taxes with which the country is familar, such as the taxes upon tobacco and upon alcoholic beverages.

Sales Tax

Before arriving at a conclusion regarding the sources of revenue which should be substituted for the tax on excess profits, the Committee endeavored to canvass all possibilities, including the different proposals for a general consumption tax through a tax on sales. Such a tax has been urged in at least three forms.

General Turnover Tax

The most extensive form would be a small and uniform levy, usually suggested as 1%, upon the price at which any commodity, thing, or service is sold. It would be collected upon the sale of raw material to a manufacturer, upon the manufacturer's sale of his product, upon the jobber's sale, and so on, with the last tax of 1% upon the retailer's sale to the ultimate consumer. A more limited

Limited Turnover Tax

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than to abolish it. A tax which falls only upon unusual profits leaves the orderly processes of business undisturbed. The owners of a corporation who hoped it would earn 10 or 12% in accordance with the usual results in the business do not suffer great hardship if, upon its earning 30%, the corporation pays a tax which, under the present law, leaves about 24% to it, so far as this tax is concerned. The portion of the enlarged profits that remains after the tax is paid is substantial, and should be sufficient to prevent the carelessness in business conduct which the Committee mentions. Combined income and excess-profits taxes rarely exceed 33% of a corporation's net income.

Effect on Prices

A statement has been made frequently, although not by the Committee, that the excess-profits tax has increased prices. Some economists contend that the tax has not in any direct way had this effect, and suggest that when its rate was lowered by one-half, for the taxable year of 1919 and subsequent years, prices continued to advance, and have now taken a downward turn without any change in the rate for 1920; they also assert that prices rose more in the twelve months preceding enactment of the original law of 1917 than in the following twelve months.

Revenues Produced

In producing revenues the tax has been very successful. Since it was first imposed, for 1917, it has already yielded almost $6,000,000,000 to the Treasury. For 1920 the Treasury originally estimated the yield at $1,250,000,000, but recently would seem to have decreased the estimate to $900,000,000. Even if business conditions were stable at the 1919 level, however, the returns from the present tax would diminish yearly, by something like $160,000,000, by reason of increases in invested capital.

Sources Other Than Income Tax

There are other possible sources than the income tax for substitute revenues, if they are needed, and it is undesirable to depend too largely upon one source of revenue.

Customs Duties

Customs duties levied for revenue purposes alone would yield good amounts. Changes in the nature of our imports have greatly altered the effect of the present tariff law. In 1914 duties collected under the present law equalled 14% of the value of imports. The percentage is now only a fraction over 6. If the law were so changed as to restore the percentage of 1914 it would yield, instead of the $322,000,000 collected in the twelve months ended with June, 1920, the sum of $733,000,000. If the percentage were raised to 20, the figure at which it stood in 1912, the yield from this source would be $1,047,000,000. Even if it were decided that neither of these percentages can be attained because of the increased volume of crude materials for use in manufacture now included in imports, it could be maintained that several hundred million dollars of additional revenue may be obtained from customs duties.

Estate Tax

The present federal estate tax might be increased. Beginning in effect with 2% upon $50,000 to $150,000 it rises by steps to 25% upon the excess over $10,000,000. During the fiscal year closed with June, 1920, this tax yielded $103,000,000. Even if it is conceded that this federal tax cannot go too high, because the states have generally preempted this source of revenue, it might be argued that the rates could be increased to yield at least $50,000,000 more.

Proportion of Income Tax

The Committee recommends some increase in the part of the revenues derived from the income tax on individuals. If the present rates on personal income were levied for 1921,—the first year as to which the proposal would be effective,—the yield would be something like $1,290,000,000, of which $301,000,000 would come from normal tax and $988,000,000 from surtaxes. If the receipts from all taxation are estimated at a billion less than in the twelve months ended with October, 1920,—i. e., at four and one-half billion,—personal income tax would account for approximately 29%.

Excise Taxes

There should be no increase in excise taxes. On the contrary, excise taxes should be decreased because of the inequalities they produce.

In the last twelve months ended with October, 1920, collections from existing excise taxes aggregated $1,466,000,000, with some of the items:

Tobacco	$284,600,000	Conveyances, stock issues, etc.	$62,200,000
Freight and express	158,100,000	Telegraph messages, etc.	26,600,000
Automobiles and accessories	152,400,000	Jewelry, watches, etc.	26,600,000
Decedents' estates	116,300,000	Candy	23,900,000
Passenger transportation	110,300,000	Insurance	19,600,000
Admissions to amusements	83,900,000	Furs	10,500,000
Non-alcoholic beverages, ice cream, etc.	$63,600,000		

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form of turnover tax has in effect been advocated by persons who would exempt all sales of capital assets and limit the levy of 1% principally to each sale of goods, wares, and merchandise in their progress from the state of raw materials to finished articles in the hands of the consumer. The third form that has been suggested would be a tax of 1% upon only one sale,—the final sale to the consumer.

Retail Sales Tax

Principles Involved

Various arguments have been brought forward in support of sales taxes of one or another of these forms, but in the opinion of the Committee these arguments are overcome by important objections to any attempt to use such a source for federal revenues. In the first place, the application of any of these taxes and its successful administration would not be so simple as is often supposed. In declining markets and under conditions of close competition turnover taxes would frequently have to be borne by the seller, and in many instances might for him be an added cause of loss. Even if passed on, through addition to the price paid by the buyer, it would almost inevitably be pyramided, causing material increases in many prices paid by consumers.

There are still more fundamental considerations weighing against such a tax. One of the objections to the excess-profits tax would apply with added force; this is uncertainty in yield of revenues; for gross sales fluctuate more widely than net income. If any form of turnover tax were imposed, it would result in advantages for large industrial undertakings which begin their processes with raw materials and carry them through to the finished product; such "integrated" industries would be subject to the tax but once, whereas their smaller competitors acquiring materials from independent sources would have the tax in their prices several times, and probably increased in effect through pyramiding. Finished articles imported from abroad would have a similar advantage over domestic manufactures.

Perhaps the greatest inequity, however, would appear in the proportionate results of any of the taxes here under consideration upon the person with small income as compared with the person of large income. At the bottom of the economic scale are persons whose income barely suffices to provide them with necessities of the poorest quality and in the smallest amount and at the other end of the scale are persons whose expenditures for necessities, no matter how large, represent but a fraction of their income. Any tax falling upon general expenditures is consequently disproportionately heavier for persons of smaller incomes as compared with persons of larger incomes. To the extent sales taxes of the sorts that have been suggested were used as a general source of revenue, there would be departure from the principle that taxes should be levied in accordance with ability to pay.

Finally, there would seem to be legal difficulties in the way of a general sales tax. Opinions handed down by the Supreme Court in

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To produce the revenues that are sought, excise taxes have already been extended beyond objects like alcoholic beverages and tobacco, which used to form the principal sources of these revenues. Constituting additions to prices, these taxes handicap various industries, and in some instances apply to necessities.

Sales Tax

The sales tax is advocated as a means of obtaining greater equity in taxation by using a source of revenue which is broader than any source now utilized.

The proposal is in effect that instead of the tax on corporations for excess-profits there should be substituted a tax of a small percentage upon sales. Although there are other incidents to different forms of the proposal this is the main feature.

A sales tax of a uniform percentage will not involve so many administrative difficulties as the excess-profits tax. For dealing with a sales tax, the Bureau of Internal Revenue has not only its large staff at Washington, as soon as it has completed its task with excess profits taxes, but also upwards of 300 offices throughout the country. Whether the tax is collected by stamps on invoices or by returns from sellers' books, collection will be simple and the verification will be easy, involving only a brief examination of sellers' books instead of settlement of complicated questions about invested capital, etc. This simplification will save business concerns large sums of money in special expenses they now have to incur in connection with their present taxes; this burden of expense has been estimated to aggregate $100,000,000 a year for the country.

Administration

Expenses Now Incurred by Taxpayers

Means can be devised for the purpose of preventing the seller from having to absorb the tax. In Canada, where a sales tax upon each turnover of merchandise by a manufacturer or wholesaler was put into effect in May, 1920, the law provides that the tax is to be set out separately upon the invoice which is required with all sales, and forbids the seller to absorb more than a part of the tax. To avoid pyramiding of the tax the Canadian law forbids calculation of any profit upon the tax. The Canadian law also takes into account possible discrimination in the event a manufacturer sells directly to a retailer, by doubling the rate of tax in such cases. Similarly, means might be found for preventing advantage to imported goods and for equalizing the sales tax as between articles produced by "integrated" concerns and by their unintegrated competitors.

Identification of Tax

Canadian Law

The taxes which a sales tax would replace are an incubus upon the conduct of industry and commerce. Their amounts are uncertain; their payment often cannot be made out of current funds but only through liquidation of assets or some equivalent; their exaction, being for an arbitrary period, may have no relation to the ultimate profit or loss in the completed business transaction. Imposition of a sales tax would continue the policy of having taxes arise in connection with business transactions but would at the same time remove the disastrous incidents which accompany the present tax. A small tax, the amount of which is insignificant in each instance it is applied but which gives large yields in revenue and which permits the taxpayer to know exactly what he is to turn over to the government, possesses the greatest practical virtues a tax can have. Such a tax is actually collected. No one has a special incentive to evade it. The collections will consequently come much nearer to the amount due than in the case of our existing tax on excess profits.

Equity of Sales Tax

Collectibility

Achievement of such important purposes would benefit the whole community. In these benefits every member would share, the poorest getting the largest advantage, according to the Committee's own reasoning. Payment of the amount of a sales tax by persons with small incomes would be less onerous for them than the heavy indirect tax they now pay; for an excess-profits tax exceeding a billion dollars annually cannot be collected without the tax being passed on in large amounts. Moreover, it is correct in principle that all persons, economically self-sustaining, should pay some tax; it is subversive of the principles of democratic government that any part of the community, which is not being maintained expressly as a public charge because of infirmity, should be wholly relieved from taxation and the load of taxation placed upon any particular class or group.

Persons of Small Incomes

The yield of a sales tax is difficult to compute with accuracy; not having had such a tax we lack precise data. Using available statistics, however, an official of the Treasury Department has recently placed the probable yield from a general and all-embracing turnover tax of 1% at $1,575,000,000 a year, and of such a tax upon turnovers except sales of real estate, securities, etc., at $1,100,000,000. Informal estimates have been made by other persons who are connected with the Treasury and who have reached about the same figures. From similar sources there have been

Revenues

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March and June of this year make it clear that such a tax is not authorized by the income-tax amendment to the Constitution. Whether or not it would be held by the courts to be an indirect tax is uncertain; if it were held to be a direct tax, it would under the Constitution have to be apportioned among the states in accordance with their population,—an obviously impracticable procedure. Reliance for revenues in large amount should not in any event be placed upon a tax regarding the legality of which there is doubt.

Committee's Views

The considerations which have been outlined above lead the Committee to believe that none of the three forms of sales tax should be imposed. In recognition of widespread interest in taxes of this nature, however, the Committee suggests that the organizations in the membership of the National Chamber should be asked to express their position upon each of the general forms of sales tax that have been brought forward. These forms are:

Questions For Referendum

A small uniform tax upon every business transaction,—i. e., a "turnover tax;"

A small uniform tax upon every business transaction in goods, wares, and merchandise,—i. e., a limited turnover tax;

A small uniform tax upon the final sale of goods, wares, and merchandise to the consumer,—i. e., a retail sales tax.

Equalization

In a very imperfect degree the present excess-profits tax serves a useful purpose. This is equalization of taxation as between corporations on the one hand and on the other hand partnerships and individuals engaged in business. As the Committee advocates abolition of the excess-profits tax, it has considered other means for seeking equalization; for unless a substitute is provided for this function, the corporate form of doing business will have an advantage in that upon the amount of current earnings kept in the business a corporation will pay no taxes comparable to the surtaxes which competing individuals and partnerships will have to meet upon the portion of their earnings they devote to their businesses.

Relief for Savings

Obviously, such an extent of equalization as is possible in this situation might be obtained in either one of two ways. For individuals, acting in business alone or in partnership, there might be a designated amount of relief from income taxes upon the portion of their income that is saved and reinvested in such form that the future income to which it gives rise will be subject to federal taxation. There would be much public advantage in promoting thrift by such a provision. This approach to the problem, it is to be observed, involves a decrease in the revenues of the government.

Tax on Undistributed Corporate Net Income

The problem can also be approached through an additional tax upon the portion of a corporation's net income that is not distributed in dividends and consequently is not made subject in the hands of shareholders to the surtaxes on individual income. This method of equalization will increase the government's revenues. Because of the multiplicity of situations, exact equalization is not possible but a scale of

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estimates that a tax of 1% only upon the final retail sale of merchandise would probably yield from $350,000,000 to $450,000,000. The productive powers of a sales tax therefore would cause such a tax to reduce the present excessive dependence of the Treasury upon various forms of taxes that go back to net income as a basis.

France and Canada

That the yields of turnover taxes in France and Canada have not yet equalled estimates is not an argument against such taxes. In neither country has there been opportunity for the machinery of collection to become adjusted. Under the French law,—which was enacted in June, 1920, and which levies a turnover tax at 1% generally, but 10% and even higher for some businesses dealing in luxuries, etc., sellers making monthly returns from books in which they enter sales,—the yield has been large. In October it was 234,000,000 francs whereas the estimates were for 160,000,000; for the whole period since the law became operative the yield through October was about 527,000,000 francs as against estimates of 1,100,000,000. In Canada, the collections through October have aggregated $31,000,000. In the Philippines, where a turnover tax on merchandise was introduced in 1904 as part of a new tax plan doing away with the confusion left by the Spanish regime, the tax is firmly established and works well. Formerly one-third of one per cent, it is now 1%.

Philippines

Legal Questions

About a general sales tax there is no more legal doubt than regarding other important taxes which have been levied. An example would be the corporation excise tax of 1909. The doubts to which the Committee refers arise out of a difference between a direct and an indirect tax, and the present legal difficulty in defining one or the other. Arguments against the existence of any doubt might be advanced,—such as reference to the undoubtedly broad sweep of the federal government's taxing power except in so far as expressly limited by the Constitution, the decision of the Supreme Court that although a tax upon net income arising from personal property is direct a tax upon income from trades, employments, professions, and vocations is not, and the character of a sales tax as a duty, impost, or excise. The question as to whether or not a sales tax should be adopted in the United States should not, however, turn upon such arguments, but upon the economic and business soundness of the tax. Under our system of government, the legal possibility of any tax can be ascertained only after the tax has been put into force; otherwise, it cannot get before the courts.

Undistributed Corporate Earnings

The proposal for a tax upon undistributed corporate earnings proceeds upon wrong premises.

Business Entities

Equalization such as the Committee describes should not be sought by attempting to assimilate corporations to individuals and partnerships. In our income tax law there was an original mistake in that a business partnership was not treated as an entity. This should now be corrected by changing the treatment of individual proprietors and partnerships. This can be done by dealing with them as business entities. Then real equity in taxation as among these forms of business enterprise can be obtained. Equity cannot be obtained by a reverse process, such as is proposed.

If each business enterprise, regardless of its form as an individual proprietorship, partnership, or corporation, were considered an entity for purposes of taxation, a distinction of fundamental importance could be made in taxation. This is the distinction between business income and income which accrues to an individual for his disposal,—for personal expenses, for beneficial or detrimental pleasures, for utter wastage, or for devotion to economically productive purposes. Income accruing to the individual in his personal capacity may properly be subject to higher taxes than income that accrues to a business, even though it is the individual's own business, and is devoted continuously to the processes of production and distribution, with their ancillary services. Business income which is not distributed to individuals for their personal disposition is added to the store of capital and without the hazards of wastage incident to personal disposition contributes directly to increase in the country's wealth.

Business Income

Business Principles

Business men instinctively feel this difference. They habitually consider it essential to business enterprise that a considerable share of current earnings should be kept in the business, in order that stability and continuity of operation may be assured.

Stability

The year, which is the period for determination of earnings for our taxation, does not reflect either true earnings or true losses. Any form of taxation that exerts pressure upon business managers to distribute an undue portion of earnings of any one year will tend to weaken the whole economic structure. In the present period of readjustment, there is abundant illustration of the public advantage in business enterprise during prosperous times having had opportunity to prepare for periods when current operations must show current losses, and the desirability of conserving current net income is obvious. If provisions of tax laws prevent this, corporations will have to

Periods of Readjustment

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rates can be constructed which would be generally commensurate with the schedule of surtaxes paid by individuals upon their incomes. By reason of the nature of such a tax corporate income upon which it was paid should not be taxable to shareholders, in the event such income were subsequently distributed. Moreover, the purpose of the tax makes it appropriate that there should be no exemption for any part of the current net income of a corporation that is not distributed. The Committee's conclusion is that the problem should be met by such a tax and it accordingly *recommends that upon the portion of a corporation's net income which is not distributed in dividends there should be imposed an undistributed earnings tax at graduated rates with a maximum approaching a percentage equal to the combined normal and surtax rates such as are proposed below for saved individual incomes of the largest size.** Being intended to correspond as closely as possible to taxes borne by sole proprietors and partners, this tax should not be levied when the shareholders of a corporation assent to be taxed individually, like partners, upon the whole of the corporation's net income; for in this event real equalization will be attained.

Recommendation

Although withholding of income tax at the source has been largely eliminated in the present law it remains in one important connection. This is in respect to the normal tax on dividends. The present law under which a tax at approximately the **full normal** rate on individual income is levied on the net income of corporations, and stockholders are then exempted from the normal tax on the dividends they receive, in effect withholds the normal tax *en masse* at the source. In other words, a stockholder whose entire income from all sources is so small that he is wholly exempted from tax, or who is subject only to the half rate of normal tax, is compelled to pay the complete normal rate upon that part of his income which he receives through dividends. This is a violation of the basic priciple of income taxation, that taxes should be in proportion to individual ability to respond to the needs of the government. The discrimination which is involved is especially inequitable at a time when the number of small stockholders is growing.

Distributed Corporate Earnings

For continuation of such a withholding provision the Committee can perceive no justification. A partner is taxed as an individual with regard to the earnings he takes out of the partnership business. A stockholder should be treated no differently in relation to the corporate dividends he receives. Regarding his dividends the corporation can supply the government with specific information, exactly as it now gives "information at the source" about salaries and other payments it makes. The Committee accordingly *recommends that each individual stockholder should pay his own normal tax upon dividends, instead of having it withheld and paid by the corporation.*†

Recommendation

* Mr. Stewart dissents from this recommendation.

† Messrs. Rhett, Gray, Stewart, and Stix dissent from this recommendation, and indicate their views in a minority report, printed at page 27.

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shut down in periods of business depression, thus aggravating general conditions, or borrow money when rates are high, proportionately adding to costs.

Under the Committee's proposal, stockholders would insist upon distribution each year of practically all earnings. They could not afford to allow a corporation to pay a tax upon any considerable amount of undistributed earnings. Small stockholders would see levied on their proportionate part a tax much larger than their own individual surtaxes. Even large stockholders would take the same position; because the undistributed earnings left to a corporation after a considerable tax was taken out might be absorbed in losses in the first year of business depression which the corporation encountered. In other words, after making sacrific through the tax, shareholders would have no assurance of ever receiving the balance.

Effect on Stockholders

The proposal of the Committee would aggravate the present evil of taxation of paper profits. In normal times and in times of increasing business, a large part of "earnings" are not in cash, but in materials and other forms of business property. Such profits are not susceptible of distribution. To meet such conditions corporations, under the Committee's proposal, might have to borrow money to pay dividends.

Paper Profits

In any event, if such a proposal as the Committee advances is adopted, the period in which earnings are estimated for purposes of taxation should be lengthened. In England, taxes on income are not levied according to the vicarious results of a year, but in effect upon the results as spread over three years.

Tax Period Should be Lengthened

The corporate income tax should not be abolished.

Corporate Income Tax

A majority of the Committee recommends that the income tax on corporations, as such, should be repealed, and that its place should be taken (1) by imposition of the normal personal income tax upon dividends received by stockholders and (2) a special tax upon a corporation for its undistributed net income. The second proposal has been discussed above. Regarding the first proposal a minority of the Committee dissents and files a separate report, which is printed at page 27. To the statements of the minority some considerations may be added.

Minority Report, Page 27

So long as our system of income taxation remains fundamentally unchanged, each business entity should pay tax upon its net income. By common acceptance and by decision of the courts, a corporation is a separate entity distinct from its stockholders. Its character should not be obscured. If confusion on this point appears in taxation it will undoubtedly spread and there will be danger that the American development of the corporation as a generally beneficial instrumentality for business enterprise will be harmed.

This very development gives rise to reasons for taxation of corporations as such. In recognition of this England has in 1920 imposed a special tax on corporations. In partial explanation, it was said, "Companies incorporated with limited liability enjoy privileges and conveniences by virtue of the law, for which they may well be asked to pay some acknowledgment." This was the basis of our corporation excise tax of 1909, which was upheld by the Supreme Court, and is still found in the present income-tax rate for corporations. According to the recommendation of a majority of the Committee, this part of the present rate on corporations, as well as the rest of the rate, would be repealed.

Readjustment of high rates of surtax is not sufficient. The entire structure of rates of tax upon personal income should be rearranged.

High Surtaxes

Effect of Present Rates

The evil which the Committee seeks to remedy is very real. Between 1916 and 1918,—the period when our present high surtaxes went into effect,—the number of persons with incomes exceeding $300,000 subject to federal taxation fell off by 53%. In 1916 persons who have incomes over $300,000 a year, and of whose income the present law consequently takes from 53 to 71%, showed an aggregate of $997,000,000 subject to federal income tax; in 1918 persons falling in the same class had an aggregate of only $392,000,000 subject to the federal tax, and it is probable that they are now subject to tax on a still smaller aggregate. This decrease means a loss to the Treasury exceeding $40,000,000 a year in normal tax alone. The change in the aggregate can scarcely mean that persons with incomes of this size have correspondingly lower incomes; to a large extent it demonstrates that such persons have placed their investments in forms such that under the Constitution the income is free from the federal tax.

Committee's Alternative Suggestions

To remedy this condition of affairs the Committee makes two suggestions, in the alternative. The first suggestion is that the higher rates of surtax should be reduced,

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Reduction in High Rates of Surtaxes

In our present rates of tax upon the income of individuals there is an evil of great public consequence. This is the effect of the exceedingly high rates of surtax upon persons with large income. Quite apart from the interests of persons with such incomes, these rates are causing serious public detriment, in that they are not producing revenues for the government in the amount that should be expected and they are causing diversion of capital from the country's industries. With large amounts of securities outstanding from agencies of such a nature that, under present law, the interest is free from federal income tax, certain of the present surtaxes are so high as to result in the taxpayer shifting much capital from investments in industrial and commercial activities to these tax-free securities. The amount of these securities outstanding has been increasing by large amounts. Bearing in mind that the purpose of taxation is to produce revenue, the Committee recommends that the high surtaxes should be so readjusted as to be more revenue-producing or that a reduction in the present rates over and above a full revenue-producing rate should be made on that part of the income which is saved and invested in taxable securities and maintained in that kind of investment.

Exemptions

The Committee has noticed the situation which arises by reason of the existence of large amounts of securities the interest on which is now free from federal income taxes. Such securities as are already outstanding have certain equities attaching to them, and respecting the exemption of their interest there should accordingly be no change in the law. Moreover, as the Supreme Court decided in June that the Sixteenth Amendment to the Constitution does not extend the federal taxing power to any subject earlier excepted, it would seem that future issues of bonds by states and their subdivisions cannot be made subject to federal income taxes so long as the Constitution remains in its present form. That this should be the situation with respect to future issues causes us regret, as the existence of an increasing body of securities the interest on which is free from federal tax will afford means for having income free from federal tax. As to other future issues the Committee wishes to record its strong conviction, and recommends that *there should be no exemption of any future issues the income from which may lawfully be made subject to tax.* This recommendation is made irrespective of the source of the issue,—i. e., whether the source is the federal government or some agency such as a federal farm loan bank.

State and Municipal Securities

Recommendation

Interest from Mortgages

Questions of exemption arise in other ways. For example, it has been suggested that the interest upon an individual's holdings of mortgages upon improved real estate should be exempted from income tax, in order that larger amounts of money may be attracted into this form of investment. However pressing the current need for more housing, the Committee believes that the desirability of uniformity in taxation, and of prevention of an increase in the burden of taxation in other directions to compensate the loss in revenue from

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and the reduction should be to a point such that persons who have large incomes will have less inducement to shift their investments into forms free from federal taxation and also that persons with large incomes who have already made changes will transfer their investments back to taxable forms. Thus, the aggregate of large incomes upon which the federal tax falls would be increased, and the federal revenue from this source would be proportionately enlarged.

Reduction in Surtaxes Required

Because of the diverse elements which will appeal to a taxpayer,—and the proposal to obtain more revenue by reducing surtax rates necessarily depends for its success upon appeal to the taxpayer, who has the decision as to whether he will place his investments in taxables or nontaxables,—the revenue-producing point which the Committee mentions is difficult to indicate. It may be pointed out, however, that in order to keep 5% for himself a taxpayer with net income of $50,000 must receive 6.41% from a security the income from which is subject to the present federal tax; in order to keep 5% a taxpayer with an income of $200,000 must receive 10.10% from such a source. It would seem, therefore, that for the purpose the Committee has in mind the surtaxes would have to be reduced at least to the rate now applicable upon an income of $50,000. Of the total of such an income the present law, through both normal and surtaxes, takes 18%. The surtax on income between $48,000 and $50,000 is 23%. It will be noticed that even this surtax may be too high for the purpose in view; in fact, some students think the surtax cannot go higher than 20%, thus making the whole tax, normal and surtax, upon amounts over forty-four thousand dollars 28%. Changes in the surtax rates on incomes over $50,000 would affect the taxes paid by about 15,000 individuals who in the aggregate receive about one-tenth of the taxable net personal income in the country and who now pay approximately 54% of the entire yield of the tax on personal incomes.

Alternative Suggestion

The Committee's alternative suggestion is that surtaxes should be reduced in the manner discussed above, but only upon the portion of an individual's income that is saved. In other words, this is a modification of the first suggestion. At the same time, the Committee apparently means to suggest that reduction of the surtax rate on account of savings should accrue to the advantage of all taxpayers, and not merely those whose incomes are so large as to be reached by the higher rates. Similarly, in the first suggestion the Committee would seem to contemplate a regrading of the lower surtaxes to the rate at the "revenue-producing point," this regrading being made with a view to increases in the present lower rates, in accordance with the attitude of the Committee expressed on page 8.

Principle Involved

In principle, the proposal for reduction of surtaxes on savings is not altogether desirable. It is opposed to the essential theory of income taxation,—that all income should be subject to tax in accordance with ability to pay and regardless of the disposition which is made of the income. Any abatement of the tax upon the part of the income that is saved makes a higher tax upon the portion which is used for living expenses and in other necessary directions, as well as any portion used in extravagant ways. Consequently, the tendency of the Committee's suggestion is to change the character of the income tax to the extent in which the abatement is given; for to the degree of the discrimination against income that is spent there is in effect a consumption tax.

Savings Invested in Nontaxables

The Committee's proposal as to saved income, it will be noticed, would limit relief only to savings invested in taxables. It can be argued that the same inducement to thrift should be given through extension of the relief to investments in nontaxables, which for many persons of small income include Liberty bonds. Such an extension would help the market for such bonds.

Rearrangement of Whole Income Tax

It can be argued that the end desired by the Committee can be better attained in another way,—i.e., by complete rearrangement of income-tax rates. After long years of experience, England uses a high normal rate with moderate surtaxes, and enlarges or diminishes its revenues chiefly by changing the normal rate. The advantage of this course from the Treasury point of view is that the normal tax reaches all taxable income, whereas the surtaxes at best touch only a part. Through normal tax England has recently been collecting 88% of its whole revenue from income tax. Its full normal rate, reached upon income exceeding $12,500, has been 30% and its surtaxes 5 to 22½%; the number of persons showing large taxable incomes has been increasing, under the English tax. Our procedure has essentially been directly opposite. Instead of looking chiefly to alterations in the normal rate, we have relied largely upon changes in surtax rates to obtain more revenues, with the result that we have placed some of the surtax rates at heights where they defeat the very purpose of taxation. Upon the normal tax we have depended for only 25% of our income from individual income. The percentage

British Tax

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Merchant Marine Act (Law of June 5, 1920, Sec. 23)

such exemptions, outweigh the arguments which have been brought forward in favor of the exemption. A recent enactment of Congress permitting certain exemptions from income and excess-profits taxes for shipping companies should not be taken as a precedent but should rather be repealed.

Americans Abroad

In another field there are requests for exemption that rest upon different grounds. These requests are made upon behalf of Americans who reside abroad and receive income from their business activities in other countries. Under existing law an American citizen residing abroad is subject to the American income tax as to income he derives from activities or investments wholly outside the United States. Double taxation is avoided through a provision in the law that if income or profits taxes have been paid abroad they may be deducted from the tax levied by our law.

It may be true that such an American citizen has more frequent occasion than his fellow citizens at home to utilize the special facilities of our government, but this circumstance would seem to be offset by the disadvantages under which he is placed in competing in business with citizens of other countries. Citizens of the country where an American is resident may not be subject to corresponding taxes. Besides, citizens of some other countries, like England, are not subject to taxes upon income which they derive from activities in foreign countries where they are resident. Having in mind the principles which should be followed in taxation and also the business situation of citizens who take employment or enter upon business enterprise in a foreign country, the Committee recommends that *American citizens resident abroad should not be subject to income tax in the United States upon income derived from employment, business activity, or investment in a foreign country, except as to amounts remitted to the United States.*

Recommendation

A question arises as to American corporations which are in a position that is substantially comparable and especially as to such corporations as operate in countries which do not have adequate legislation for local incorporation of subsidiary companies. There is a difference, however, between such companies and the persons to whom the last recommendation refers; for the companies are resident in the United States. On this point of residence the British courts have worked out a distinction between companies incorporated under the laws of England and controlled from the United Kingdom and companies which have their principal offices elsewhere. The latter are subject to the British income tax only upon remittances to the United Kingdom. A similar point of view has never been taken in the United States with respect to companies incorporated under the laws of the various states, and even in England the recent Income Tax Commission has proposed some limitations upon the practice of having British companies controlled outside the United Kingdom free from British taxes. Taking into account the different situation

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of total income taken by the tax in England rises steadily until it reaches 52% on amounts over $5,000,000, whereas in the United States the percentage is light on the smaller incomes but rises sharply to a maximum of 71%. The revenues from income tax could be increased in the United States, and at the same time the larger incomes could in practice be made more productive of revenue to the federal government, if our income taxes were readjusted upon the British principle.

Tax Exemption

There are some reasons for exemptions from taxation by the federal government.

Bonds

The Committee opposes exemption of future issues of bonds of the federal government and of such agencies as farm-loan banks. Such exemption has become traditional in the United States, and exists to a greater or less extent as to interest upon all outstanding federal obligations, including those issued during the war with Germany. The practice of the federal government is supported by at least three considerations. The exemption saves the government the cost of collection of tax upon the interest, being tantamount to a withholding of the tax at the source; if the government pays out interest and then proceeds to get part of it back as a tax it incurs unnecessary cost and usually loses a part of the tax. Exemption enables the government to sell its issues with a lower cost for interest charges. As the states, because of difficulties with the inequalities of the general property tax, have an added reason to issue their securities upon a tax-exempt basis, and interest on their bonds cannot in any event be made subject to federal income tax, the federal government would have to compete with states and municipalities upon an unfair basis if it did not attach tax exemptions to its bonds. It may be added that tax exemption of federal issues is less objectionable than of state or local issues, since the federal government by exempting an issue of its own distributes the resulting burden over the whole country. Thus, it can be argued that exemption of farm-loan bonds placed a corresponding burden upon the whole country for the benefit of agriculture throughout the land, and that the national interest in promotion of agriculture warrants this.

Farm-Loan Bonds

Housing Mortgages

Although the Committee's recommendations respecting income tax rates might make more money available for mortgages upon real-estate improvements, it can be urged that this will not be enough and that there is the same reason for an exemption of interest on mortgages upon city dwellings as has been suggested above with respect to farm-loan bonds. There may be said to be a national emergency in housing, largely due to drainage of funds from the mortgage market through the operation of the present federal surtaxes on income, and that the national interest requires an exemption here to make adequate housing possible. The national interest in promotion of a privately owned and operated merchant marine may likewise support the exemptions from excess-profits tax now given by law to net earnings of American shipping companies, and to gains from sales of vessels bought before 1914, upon condition that an amount at least equal to the tax upon earnings and the whole proceeds of sale are invested in building new vessels in American yards.

Merchant Ships

Americans Abroad

A citizen's obligation to do his part in supporting his government exists regardless of his place of residence and the source of his income.

So far as American citizens are concerned, their liability to pay income tax is made absolute under the present law. It is immaterial where they reside or carry on the business or employment from which their income arises. This accords with the essential principle of income taxation, especially when careful provision, such as our law contains, makes allowance for taxes paid elsewhere. Against exemption in this case much the same reasons weigh as against exemptions in other directions.

Such an exemption as in proposed may work injustice as between citizens. A merchant on the American side of the Mexican border may be subject to heavier taxes than a merchant a short distance away on the Mexican side. An American trading from the United States to a foreign country may be subject to heavier taxes than an American who resides abroad and trades in American goods. The exemption may even have something of the effect the Committee finds in nontaxable securities, in that it may lead some citizens to withdraw their residence and their investments from the United States during a period of heavy taxation.

Amounts of income remitted to the United States should not be taxed here, if the Committee's main proposal is accepted, and they have been assessed with substantial income taxes abroad.

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in the United States, and the importance of having no discrimination among American companies in their operations abroad, the Committee believes that there should be no attempt to exempt any companies incorporated in the United States.

In another respect our present law should be changed, in order that it may not prove an obstacle to normal business transactions or produce results so inequitable that they cannot have been intended.

Capital Assets

Sales of property of different kinds, which if consummated would have contributed to increased business activity, have been prevented because all of the increment in value, often not a real increment but a paper change because of alterations in the value of money, would have been taxed as income in the year of the transaction. Sales here in question are not by dealers in such property, but by persons or corporations that would be transforming capital assets. In order to remedy the situation which has existed, the Committee recommends that

Recommendation

profits arising from the sale of capital assets should be allocated pro rata over the period, since March 1, 1913, in which they were earned, and should be taxed at the rates of the years in which they were earned.

Exchange of Assets

As the law now stands it produces important consequences in business operations through which no real gain or loss accrues. These results follow from the provisions about exchanges of property. When property is received in exchange for other property, gains or losses are now estimated according to market prices, and if securities are involved, and a person receives in exchange a face value greater than he gave, there is a computation of gain on the excess in accordance with market values. It is proper that there should be adequate safeguards against evasion of tax through simulated exchanges which in fact are sales through which profits are realized. These safeguards need not be of such a nature as to hamper legitimate business processes when one asset is merely substituted for another, and they should not lead to computation of paper profits to the enhancement of the revenues or of paper losses to the detriment of the government. Having in mind these considerations, the Committee recommends

Recommendation

that *in an exchange of property of a like or similar nature it should be assumed there is merely a replacement in the course of which no gain or loss occurs.*

Losses

When the Revenue Act of 1918 was under consideration Congress made provision for adjustments on account of losses which accrued before January 1, 1920. This date was apparently chosen on the assumption that in the interval business would return to an approximately normal basis. One of the provisions allows a taxpayer to present to the Commissioner of Internal Revenue a net loss sustained by him in business in the taxable year of 1919 and have such a loss deducted from the net income shown upon his return for 1918, with a redetermination of the tax for 1918. A second provision permits a similar readjustment in the event that there was before Jan-

Section 204

Section 214 (a) 12

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Increments in Value

Increments in value of capital assets do not in any sense constitute income and accordingly should be wholly free from income tax.

The Committee in effect takes the position that advances in value, when realized, constitute income, but that they should be prorated over the period during which the advance occurred, or since 1913, and the portion so allocated to each year taxed at the rate in effect for that year. This is in effect the provision made by a bill which is supported by the Treasury Department, has passed the House, and may come before the Senate during the present session. The bill deals with "extraordinary income" received in any year for personal services extending over at least three years or from sale of capital assets held for at least three years; if extraordinary income exceeds 20% of the taxpayer's gross income for the year, the taxpayer has the option of prorating it and paying tax accordingly. The bill in some respects resembles existing law in the case of oil wells, mines, etc.

H. R. 14198

Extraordinary Income

Principle Involved

Both the Committee's recommendation and the bill are wrong in principle, in that increment from sale of a capital asset should not be subject to any income tax. The bill is also erroneous in requiring that such an asset must have been held for at least three years; so long as it is a capital asset, and not a thing in which the taxpayer deals as a trader, it should be immaterial whether it had been held ten minutes or ten years. Under an income tax no part of capital should be taken under the guise of a "gain." Only a capital tax should reach increments in value of capital assets, and the federal government cannot constitutionally levy a capital tax unless it is apportioned among the states,—a condition which by general agreement makes such a tax impossible.

Price Levels

Under the Committee's recommendation the government would continue to levy tax upon capital by reason of increases in price levels. For no other reason a piece of real estate costing $10,000 in 1913 may now, without change in any other condition, sell for $15,000; it may have been the taxpayer's home, which he wishes to sell merely that he may buy a duplicate house elsewhere; yet, he is required to pay income tax on $5,000. That the amount of tax may be decreased does not make the tax any less objectionable in principle. An oil man or miner, who has discovered and developed a property, gets a concession under existing law, which limits the surtax upon "profits" from a sale to 20% of the selling price, regardless of the relation of this 20% to the amount of "gain." A man who may have held stock for years without a dividend cannot sell without paying a considerable part of any "gain" in income tax. A company holding capital assets which have increased in market price, as measured by present money values, cannot liquidate without severe cost to the stockholders.

Losses

The policy appearing in the present law is partly offset by a provision allowing deduction of losses which are incurred in capital. So long as the policy of the present law is continued, the provision respecting losses should be kept, but if the law were so amended as clearly to define capital and income, and exclude from liability to income tax increments to capital, the deduction of losses from income should be stopped.

Exchanges

Exchanges of property cannot be permitted, without resulting gains or losses for purposes of taxation, and the way not be opened for evasions and for inequity as among taxpayers.

An income-tax law cannot make fine distinctions. It has to use rather general tests. Thus, the market value at the time a piece of property is received in exchange is the best test yet found. Unless such a test is used, and tax assessed accordingly, exchanges of property might be used to a considerable extent in avoiding taxation.

Distinctions such as would have to be drawn under the Committee's recommendation are illustrated in the recent report of the British Commission on the Income Tax. The Commission took the position that the owner of a dwelling house which he occupied should not be subject for income tax on any "profit" when he sells after a number of years, but that his neighbor, who invested in a residence purely for his chances of gain in selling it, should pay tax accordingly. At the same time, the Commission found it impossible to devise a rule which could be embodied in the statute and suggested that in each case the distinction be drawn by administrative authority. Decision in such a way about matters of this kind is even more objectionable, from some points of view, than present American law.

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uary 1, 1920, a substantial loss resulting from any material reduction in the value of the inventory.

The industrial readjustment to which Congress looked forward when it enacted these provisions has in large measure been delayed beyond the date fixed in the law. The rigidity caused in the law by inclusion of other precise dates, such as October 31, 1918, as the earliest date on which a taxable year could begin if a net loss were to be a cause for redetermination of tax, has already led to hardship and inequity in individual cases, and probably these instances cannot now be remedied. There will be more numerous instances in which losses will occur in 1920, and these instances fall clearly within the purpose Congress had in mind. Accordingly, the Committee recommends that *net losses and inventory losses in the present and future taxable years should be deductible from net income in the preceding taxable year, with appropriate redetermination of taxes.*

Recommendation

Final Determination

Under the present law there are some conditions which the Treasury Department is helpless to remedy and which are sources only of harassment to the public. As the Secretary of the Treasury has said, no matter how conscientious the taxpayer may be, he never knows when he is through. Every time an old ruling of Treasury officials is changed, his return may be revised and some new assessment made. The Secretary recommends that Congress should authorize the Treasury to reach a final determination of any tax or assessment and that, if accepted by the taxpayer, it should be final, unless there was fraud. For the same reason, the Secretary suggests that when the Treasury itself makes a new ruling, the ruling should not be retroactive and cause a reopening of old cases. Finally, he suggests that it is only right that the statute of limitations which allows suit only within five years under the law of 1918 should be made applicable to the earlier laws, too. In these recommendations the Committee wholly concurs.

Administrative Reform

Changes of a much more fundamental nature, however, should at once be made in the provisions of law under which the income tax is assessed and collected. Because of the necessities of the government for revenues, there was acquiescence during the war in a form of procedure which ran counter to our traditions respecting taxation and to the spirit of a great principle incorporated in the Constitution.

Due Process of Law

The Constitutional prohibition against a taking of property without due process of law does not mean that the amount to be paid by any taxpayer is to be decided in the courts before he responds to a proper assessment. That might lead to intolerable postponement of the government's revenues. It does mean, however, that before any person is required to pay a tax upon income the amount of tax he is to pay should be finally determined through an orderly procedure of return of taxable income to the government, ascertainment by a proper official of the amount of tax that is due, and an opportunity for the taxpayer to be heard respecting the amount of the assessment.

Orderly Tax Administration

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Inventory and Net Losses

Readjustment of taxes on account of losses will to a serious extent cause uncertainty in the government's revenues.

The taxes payable in 1920, including the installment due on December 15, are assessed upon net income of 1919. The Committee's proposal is that if, after the close of 1920, for example, a taxpayer finds he had no net income for 1920, or that although having a net income he sustained losses on inventory after paying taxes by reason of inventory gains in the preceding year, he may have the taxes he paid on account of 1919 redetermined in such a way as to take into account these losses of 1920.

The provision allowing such redetermination of taxes for 1918 was inserted in the law for the purpose of preventing hardships in the event of a period of severe readjustment following immediately after the war. Limitation of the relief to 1919 was therefore justified. Such readjustments in business conditions as have occurred in 1920 have been delayed a sufficiently long time to allow preparations to meet them. To extend the opportunity for redetermination of taxes would unsettle the government's financial program, and possibly cause imposition of heavier taxes on other income, in order to make good the loss to the government in revenue.

So far as the proposal is advanced as a proper check upon taxation of "paper" profits, a better remedy would be an adequate definition of income in the law, and avoidance of tax upon anything out of which the tax cannot in fact be paid.

Inventory Losses

It may be argued that the Committee goes farther than is necessary to afford the equitable relief it has in mind. If inventory losses do not result in net losses for the business in the current year, it may be said that inventory losses should not be a cause for relief. Certainly, provision for redetermination of taxes in accordance with inventory losses will cause a great deal of administrative work, for which the government will have to provide large staff; for it will mean that for such a year as 1920 there will have to be computations for practically every taxpayer in whose business inventory is a material factor. Even as to net losses it can be argued that taxes should be paid upon results of business in 1919, regardless of results in 1920, since taxpayers largely had it in their own power to realize upon their 1919 profits.

Assessment

The Committee's proposal for the delay of payment until after final determination of the tax due would cause unnecessary postponement of the government's revenue.

As the income tax has now been in use for almost eight years, and it is assessed according to well-known methods of accounting, there has been so much experience on the part of taxpayers that they can with great accuracy determine for themselves the amount of tax they should pay. The difficulties which have arisen have been almost entirely ascribable to the excess-profits tax, which the Committee thinks should be repealed. Since the taxpayer is able to determine closely his own tax, it is appropriate he should make payment in accordance with his own determination, and subject to subsequent official review. Any other procedure will tend to increase costs to the government, and to postpone the receipt of its revenues.

The Committee's recommendation might mean that payment of taxes by large taxpayers would be considerably postponed. Any final determination of the tax to be paid by a large business may require months of investigation. If the Bureau of Internal Revenue had been provided with sufficient staff, properly decentralized, to make its basic determinations for each taxpayer in the earlier years of our present law, such postponement might not be necessary. Accordingly, such a proposal as the Committee makes might be delayed until the government's administration of taxes based on net income can become current.

Even in England, where the general principle of the Committee's proposal is used, the revenue authorities may cause additional assessments within three years and, on the ground that under-assessment is usually due to some error or omission by the taxpayer, the recent British Income-Tax Commission recommended the period should be lengthened to six years.

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This is the methodical course which has been worked out through centuries of experience. When the successive steps have been completed, the taxpayer must respond to the assessment. For further opportunity to have errors corrected he may be required to go to the courts.

Present Situation

Under our present law, which was formulated to meet the government's exigencies, the taxpayer has to make payment of a tax which he assesses upon himself and then wait for years,—under the law he may have to wait for five years,—to see if the taxing officials differ with his conclusions upon the facts respecting his income and either grant him a rebate, without so much as interest for the time his money has been at the government's use, or levy upon him additional assessments in heavy amounts, perhaps after such an interval of time that his whole situation has changed. In other words, the present law places the taxpayer in the jeopardy against which he should be safeguarded.

It is axiomatic in business that method and order pay, whereas confusion and uncertainty are costly. For the advantage of the government, therefore, as well as for the proper safeguarding of taxpayers' interests, the Committee recommends that *income tax should not in any instance be payable until the amount which is due has been officially ascertained and assessed, with opportunity for the taxpayer to be heard, and the amount so assessed should be subject to revision only in cases of fraud.* The United States should not now have difficulty in instituting a proper procedure. Even during the war England adhered to the principles which this Committee is now recommending.

Recommendation

British Practice

Administrative Decentralization

It will be noticed that the Committee's last recommendation would necessitate responsibility in taxation officials throughout the country. Such responsibility on the part of an official or agency before which a taxpayer can appear without undertaking a journey to Washington, either personally or by attorney, is essential if substantial rights of taxpayers are not to be denied. To obtain consideration of views with respect to positions taken by minor officials, taxpayers now have to make such a journey. Respecting any contested point, examining officials refer the taxpayer to their superior, in the district, who proves to have no real powers to deal with questions of principle.

This condition of affairs should be ended. A taxpayer should not have to abandon his rights because of the difficulties in the way of asserting them. He should in his own district have an opportunity to state his case and have it decided on its merits, subject only to appeal. Moreover, he should be able to have the decision rendered from an impartial source; for officials charged with collection of the revenues inevitably lean in their decisions toward the government, although it is a legal maxim that "when the construction of a tax is doubtful the doubt is to be resolved in favor of those upon whom the

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Decentralization

If the excess-profits tax is repealed, decentralization of administration will be neither necessary nor desirable.

Without the excess-profits tax, the federal taxes based on income will be comparatively simple in administration. Although England has developed a system of decentralized administration under central supervision, the extent of the United Kingdom is small, as compared to the United States. Corresponding decentralization here would add greatly to the cost of administration, and it would tend to impair the advantage of uniformity in application of the law that comes from the present arrangement of a large and expert staff at Washington passing upon all substantial questions of principle and distributing its decisions quickly both to its local representatives and to the public.

Present Districts

For purposes of collection of taxes that are assessed, the country is already divided into districts, each in charge of a collector and each with branch offices throughout its area. As has been indicated above, these branch offices bring the total of local offices above 300. Attached to these offices are more than 7,000 employees, this field "force" being additional to the 5,000 employees of the Bureau of Internal Revenue at Washington.

Income Tax Commission

Even with the personnel now employed, the district offices are not at present suitable to assume any important responsibility in connection with determination of taxes. Any changes in organization or duties for the part of the administration already decentralized, and any provision of organization for further decentralization, should at least be postponed until there can be very thorough study by such a body as a permanent commission devoted to ascertaining the facts about administration of taxes upon income and respecting the effects of different rates and different provisions of law, making reports to Congress of the facts it ascertains. Such a commission has been created in connection with taxes upon imports. All of the reasons which led Congress to create the Tariff Commission, for authoritative determination of the facts in order that Congressional and public attention might be centered upon policy, support the creation of a federal income-tax commission, and with greatly augmented force; the income tax is now a more important source of revenue than the tariff.

Local Appeals

In connection with the Committee's recommendation that a taxpayer should have locally an opportunity for impartial decision of questions he raises, there might be difficulties. For example, respecting a concern with branches or subsidiaries it might be necessary to decide where an appeal was to be heard.—i. e., whether at the place where the central offices are situated and perhaps far distant from the points of actual operation or at the place where the operations are conducted giving rise to the question. This illustration of practical difficulties may serve to indicate that reasons against too great local intervention in income-tax matters are even more persuasive in the United States than in England, where the recent Income-Tax Commission reported that the present efficiency of the British administration was made possible only by considerable deviation from the original British system of local consideration of income-tax question.

Conditions such as have been outlined in the last paragraph suggest that it may be impracticable to develop in the United States any form of local impartial decision upon income-tax questions. With the repeal of the excess-profits tax the importance of such questions will be greatly diminished. Besides, the income-tax is peculiarly a national tax. It should be administered in such a way that the same question is settled in the same way in every part of the country. In England, appeals from assessments on income arising in the course of business come before officials who travel on circuit to hear cases, but have a central office in London. From their decisions tax payers may take an appeal to the courts. These officials travelling circuit to hear appeals are experts in the interpretation and application of the income-tax law. Notwithstanding their official position they are accordingly in a better position to reach correct conclusions than persons who lack their training and experience. Institution of a similar arrangement for having responsible and experienced officials travel circuit in the United States, conducting hearings locally for tax payers who wish decision upon their problems, might better meet American requirements than the Committee's proposal, which has some similarity to the boards of referees used in England only in connection with the excess-profits law. These boards of referees, even in connection with the excess-profits tax, dealt not so much with particular cases as with questions of general application to a class.—such as the normal earnings of a kind of business in the period before the war.

tax is sought to be laid." The Committee believes that the purposes it contemplates can be accomplished without any impairment of a proper central control from Washington and therefore recommends that *the administration of the federal income taxes should be decentralized and there should be provision for impartial consideration of questions between the government and taxpayers.*

Recommendation

The Committee's proposal is that in each territorial district of the country, such as the federal reserve districts, panels should be set up of men who may be selected by the taxpayer and the government to act as arbitrators upon any question, with the taxpayer bearing the costs. Such a provision respecting costs will prevent wholly trivial points from being raised. The decision of such a board should be final, unless appealed to a board at Washington. This board at Washington should be independent of the Treasury Department.

*SPECIAL COMMITTEE ON TAXATION

*R. G. RHETT, Chairman,
ARTHUR ANDERSON,
R. G. ELLIOTT,
*JOHN H. GRAY,
FRED R. FAIRCHILD,
J. LAURENCE LAUGHLIN.
THOMAS B. STEARNS.
*HAMILTON STEWART,
*ERNEST W. STIX.

* Messrs. Rhett, Gray, Stewart, and Stix dissent from the Committee's second recommendation appearing on page 14, and set out their views in a minority report printed at page 27. Mr. Stewart also dissents from the first recommendation appearing on page 14.

MINORITY REPORT

Corporate Income Tax

Loss in Revenue

The majority of the Committee recommend that the present corporate income tax should be discontinued and with respect to dividends each shareholder himself should pay the normal tax, as well as the surtaxes, to which he is subject in view of the entire amount of his net income. We cannot join in this recommendation, because it would seem to cause considerable loss in revenues.

Some decrease in revenue, to be sure, would follow adoption of the Committee's recommendation, in so far as stockholders would individually be subject to lower normal rates than the present rate of corporate income tax. These are not, however, the losses we have in mind. We refer to losses that would occur in practice, because "information at the source" is not operating today in a manner which would warrant its substitution for withholding at the source in such an important extent as has been proposed by the Committee. The overburdened staff of the Bureau of Internal Revenue has not been able to utilize extensively the returns of information which are made under existing law. To expect them now to examine and check returns of information from hundreds of thousands of corporations, with the largest having as many as 130,000 stockholders, is to set a task which is incapable of accomplishment for present administrative staff. The Committee's proposal should be considered only when the arrears of administration on account of war taxation have been cleared away and the government's operations in administering taxation can be placed upon a methodical and current basis.

Methodical Administration.

Part Excise Tax

The inequities which are cited for small shareholders have not appeared so considerable to us as to the other members of the Committee. Even if there were no disagreement on this point, we wish to observe that the so-called corporate income tax is only in part a form for withholding the normal tax at the source. It is also in part a tax upon the right to do business in the corporate form, in this respect being a continuation of taxation which began in 1909. The differential of 2% in the income-tax rate for corporations over the normal rate for individuals would seem to make this clear. Removal of this differential alone, as is contemplated by the Committee as an incident to its proposal, would mean a loss in revenue of more than $100,000,000 a year.

Collection at Source with Rebate

Even if the essential feature in the proposal of a majority of the Committee were adopted, it would not seem necessary to substitute "information at the source" for "collection at the source." There would be much advantage in having corporations withhold the normal tax and pay it to the government, with a provision in the law which would permit each shareholder who, by reason of the size of his entire income, is wholly or partly exempt from the normal rate to present to the government his claim for a refund supported by a dis-

closure of the facts about his income. Through such a plan losses through evasion and incomplete use of returns of information would be checked and there would be the decided advantage found in England, in that for the sake of the refund many persons who have been escaping taxation would come forward and make voluntary declarations.

R. G. RHETT.
JOHN H. GRAY.
HAMILTON STEWART.
ERNEST W. STIX.

SECTION 9. If before the expiration of 45 days from the date the pamphlet was sent out votes representing more than two-thirds of the voting strength of the organization membership are registered in favor of the propositions submitted or any of them, the Secretary shall immediately certify that fact to the Board of Directors. Thereupon, the propositions so approved shall be recorded as having been adopted by the Chamber and it shall be the duty of the Board of Directors to take such steps as may be necessary to make effective the action taken.

If at the expiration of 45 days one-third of the voting strength of the Chamber has been recorded and two-thirds of the vote thus cast representing at least twenty (20) states is in favor of the propositions submitted or any of them, the Secretary shall so certify to the Board of Directors. Thereupon the proposition so approved shall be recorded as having been adopted by the Chamber and it shall be the duty of the Board to make effective the action taken.

SECTION 10. On a question submitted to referendum no organization member found to have voted with the minority shall be deemed to impair its standing in this Chamber by adhering to its position or by continuing its efforts in support thereof.

SECTION 11. Upon approval by the Council or Board of Directors a member may be permitted by petition to place upon the program for consideration at the annual meeting a question which has not been submitted in advance by mail as hereinbefore provided for, but such a question shall not be considered if one-third of the delegates present object thereto, and its submission by mail as hereinbefore provided for shall be ordered on the recording of a two-thirds vote in favor of that method of procedure.

SECTION 12. ACTION AT MEETING. (a) On all questions before a meeting of this Chamber on which a vote is taken viva voce, or by division, each duly accredited delegate from an organization member shall be entitled to one vote in person. A yea and nay vote may be ordered on any question upon demand of one-fourth of the delegates present officially representing such organization members and on such ballot only the votes of said members shall be counted. On all yea and nay votes each organization member shall be entitled to as many votes as there are delegates present representing said member, subject to the provisions of Article VI, Section 3. All yea and nay votes shall be fully recorded and published in the proceedings. An affirmative vote of two-thirds shall be necessary to carry the approval of the Chamber of Commerce of the United States of America upon any proposition or resolution which may appear upon the official program or be added thereto as provided for by these By-Laws: *Provided*, That such a vote shall be void and of no effect unless the attendance registered at the meeting shall represent one-third of the voting strength of the Chamber from at least twenty (20) states.

(b) The list of questions to be considered at each annual meeting shall be mailed to each member at least 30 days in advance of such meeting.

(c) No question shall be received from an organization member for submission to the Chamber at the annual meeting within 40 days of the date of said annual meeting, except in case of emergency and unless by a two-thirds vote of the Board of Directors.

END OF
TITLE